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IN THE

Supreme Court of the United States

OCTOBER TERM, 1993

CHURCH OF SPIRITUAL TECHNOLOGY,
Petitioner,

v.

THE UNITED STATES,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

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QUESTIONS PRESENTED

Pursuant to 26 U.S.C. § 501(c)(3), an organization must be "organized and operated" exclusively for one or more of the exempt purposes listed therein to be exempt from taxation. Pursuant to 26 U.S.C. § 7428, an organization may seek a declaratory judgment that it is exempt from taxation. The questions presented are:

1. Whether a court may hold that an organization is not operated exclusively for exempt purposes, based on suspicion of an unstated non-exempt purpose, where the court holds that all of the organization's activities throughout its history have been exclusively to advance its stated exempt purposes?

2. Whether in a declaratory judgment proceeding pursuant to 26 U.S.C. § 7428 a court may hold an organization to have failed to carry its burden of establishing its exempt status on grounds not set forth in the final adverse ruling of the Internal Revenue Service and advanced for the first time at oral argument on the merits before the trial court?

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Church of Spiritual Technology ("CST")[1] petitions for a writ of certiorari to review the opinion of the United States Court of Appeals for the Federal Circuit.

Opinions Below

The order of the United States Court of Appeals for the Federal Circuit ("the appeals court") denying CST's petition for rehearing (D-66) is unreported. The *per curiam* opinion of the court of appeals (A-1) affirming the opinion and judgment of the United States Court of Federal Claims ("the trial court") is unreported. The opinion of the trial court (B-2) is reported at 26 Cl. Ct. 713 (1992).

[1] CST is incorporated under the California Nonprofit Religious Corporation Act and has no parent or subsidiary companies.

Jurisdiction

The *per curiam* opinion of the appeals court (A-1) affirming the opinion and judgment of the trial court is dated March 29, 1993. The order of the appeals court denying CST's timely petition for rehearing (D-66) was filed on April 26, 1993. On July 14, 1993, Chief Justice Rehnquist extended the time within which CST may file a petition for a writ of certiorari to and including August 24, 1993. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

Statutory Provisions Involved

26 U.S.C. § 501 provides in pertinent part:

(a) Exemption from taxation. An organization described in subsection (c) or (d) or section 401(a) shall be exempt from taxation under this subtitle unless such exemption is denied under section 502 or 503.

* * *

(c) List of exempt organizations. The following organizations are referred to in subsection (a):

* * *

(3) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements),

any political campaign on behalf of (or in opposition to) any candidate for public office.

26 U.S.C. § 7428 provides in pertinent part:

(a) Creation of remedy. In a case of actual controversy involving-

(1) a determination by the Secretary-

(A) with respect to the initial qualification or continuing qualification of an organization as an organization described in section 501(c)(3) which is exempt from tax under section 501(a) or as an organization described in section 170(c)(2). . ., or

(2) a failure by the Secretary to make a determination with respect to an issue referred to in paragraph (1),

upon the filing of an appropriate pleading, the United States Tax Court, the United States Claims Court, or the district court of the United States for the District of Columbia may make a declaration with respect to such initial qualification or continuing qualification or with respect to such initial classification or continuing classification. Any such declaration shall have the force and effect of a decision of the Tax Court or a final judgment or decree of the district court or the Claims Court, as the case may be, and shall be reviewable as such. For purposes of this section, a determination with respect to a continuing qualification or continuing classification includes any revocation of or other change in a qualification or classification.

Statement

CST is a church of the Scientology religion. Scientology was founded in 1950 by L. Ron Hubbard (B-3). A fundamental tenet of Scientology is that man is an immortal spiritual being. Through the sacraments of Scientology, an individual attains

certainty of immortality and freedom from spiritual burdens (B-4).

L. Ron Hubbard's recorded written and spoken words on religious matters are the Scriptures of Scientology (B-3). These voluminous Scriptures deal with ministration of religious services and matters of ecclesiastical administration, and consist of over 11,000 published issues, over 120 published volumes of compilations, over 3,000 tape recordings of Mr. Hubbard's lectures, and over 110 instructional films.

In Scientology, spiritual salvation can be attained only by the orthodox practice of the religion, which means following the path of spiritual awareness Mr. Hubbard outlined in the Scriptures. The portion of the Scriptures that constitutes the upper levels of spiritual awareness in Scientology is called its "Advanced Technology"(B-4). Scientology churches assure parishioners that their religious services are orthodox by providing them under specific religious marks.

Founded in 1982, CST is unique among the churches of Scientology. CST neither ministers religious services to parishioners nor provides support services to other churches. Rather, CST's sole objective and function is to preserve and protect the millions of words of writings, recordings and film that make up the Scriptures of Scientology to ensure that the religion can be practiced by all generations to come (B-14).

To accomplish its objective, CST conducts a sophisticated program to preserve original Scriptural materials it has collected, to reproduce Scriptural materials on special long-term archival media, and to store preserved original materials and archival reproductions in remote, secure underground vaults (B-16-18). Through its fiscal year ending April 30, 1987, CST had spent approximately $14.6 million to carry out and support its program. As of May 1987, CST estimated it would need to spend up to an additional $36 million to complete the preservation projects it was planning at that time and future projects.

In 1982, Mr. Hubbard implemented plans to ensure the orthodoxy of the Scientology religion after his death by giving the Scientology religious marks and the right to use the Advanced Technology in the United States to a separate Scientology church, Religious Technology Center ("RTC")(B-12). At the same time, Mr. Hubbard gave CST limited options to acquire RTC's rights to the Advanced Technology and Scientology religious marks under any one of three narrowly-defined conditions (B-13).

On August 26, 1983, CST applied to the Internal Revenue Service ("IRS") for a ruling that it qualified for tax exemption under 26 U.S.C. § 501(c)(3)(hereafter, "section 501(c)(3)") (B-2). On January 7, 1986, the IRS issued CST an initial adverse ruling, relying principally upon alleged private benefit to Mr. Hubbard.

Barely two weeks later, on January 24, 1986, Mr. Hubbard died (B-12). His Estate included his copyrights to the Scriptures and his residual rights to the Scientology Marks and Advanced Technology. In his Will, Mr. Hubbard bequeathed CST the bulk of his Estate if CST obtains recognition of its tax-exempt status (B-13). If CST does not, Mr. Hubbard's Estate is to be distributed to one or more section 501(c)(3) Scientology organizations.

On July 8, 1988, the IRS issued its final adverse ruling (B-2-3), which concluded that CST had failed to establish that it operates exclusively for exempt purposes and that CST had failed to establish that it is not operated for the benefit of private interests and that its net earnings did not inure to the benefit of private individuals. The ruling also made specific findings that CST is "operated for a substantial non-exempt commercial purpose," that CST is "operated for the benefit of private interests" and that CST's "net earnings inure to the benefit of private individuals." The final ruling made no mention of CST's options, nor did it suggest in any way that CST's primary purpose

was to obtain tax-exempt status and exercise its options to shelter the income of non-exempt Scientology entities from taxation. The final ruling did not conclude that CST had failed the organizational test set forth in section 501(c)(3).

On October 6, 1988, CST filed with the trial court its complaint for a declaratory judgment.[2] The government's answer did not raise any ground for denial of exemption not stated in the IRS's final adverse ruling.

During oral argument on the merits before the trial court, however, government counsel raised a new ground for denial of exemption: that CST's preservation and archival activities were a mere pretext and that its true purpose was to obtain tax-exempt status so that it could then exercise its options in order to serve the financial objectives of non-exempt Scientology entities. On May 26, 1992, the trial court entered its opinion on the merits denying CST declaratory judgment based on the government's new ground. On June 29, 1992, the court entered a revised opinion (B-2) and new judgment (E-67) against CST, denying CST's June 5, 1992 motion for reconsideration. The court also issued an order on reconsideration (C-54) on June 29, 1992.

The appeals court issued a *per curiam* opinion dated March 29, 1993 (A-1) affirming the opinion and judgment of the trial court. By an order dated April 26, 1993 (D-66), the appeals court denied CST's petition for rehearing.

REASONS FOR GRANTING THE WRIT

This petition presents important substantive and procedural issues in the Government's administration of the provisions of the Internal Revenue Code granting exemption from federal corporate income tax. Equally important, however, are the First Amendment concerns arising from the government's treatment of a new church propagating nonmajoritarian religious doctrine.

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[2] The trial court had jurisdiction over CST's suit under 26 U.S.C. § 7428 (hereafter, "section 7428") and under 28 U.S.C. §§ 1507 and 2201.

For as long as there has been a federal corporate income tax, Congress has expressly exempted churches and other religious organizations. *See Walz v. Tax Commission*, 397 U.S. 664, 676 & n.4 (1970). Although such an exemption is constitutional only as part of a larger pattern of exemption for public benefit institutions, *Texas Monthly, Inc. v. Bullock*, 489 U.S. 1, 11-17 (1989) (plurality opinion of Brennan, J.), exemption for churches nevertheless stands on a different footing because it "operate[s] affirmatively to help guarantee the free exercise of all forms of religious belief." *Walz*, 397 U.S. at 678. The "benevolent neutrality toward churches and religious exercise" reflected in the historical tradition of exemption for churches is permissible "so long as none [is] favored over others and none suffer[s] interference." *Walz*, 397 U.S. at 676-77.

In two decisions in 1974, the Court held that organizations claiming tax exemption could not obtain pre-enforcement judicial review of adverse IRS administrative determinations.[3] The Court so held despite its recognition that its decision left far too much discretion with the IRS.[4] In response, Congress in 1976 enacted section 7428 "in order to provide an effective appeal from an Internal Revenue Service determination that an organization is not exempt from tax."[5]

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[3] *Bob Jones University v. Simon*, 416 U.S. 725 (1974), and *Alexander v. "Americans United" Inc.*, 416 U.S. 752 (1974).

[4] *Bob Jones Univ.*, 416 U.S. at 749-50 ("The degree of bureaucratic control that, practically speaking, has been placed in the Service over [organizations claiming exemption] is susceptable of abuse, regardless of how conscientiously the Service may attempt to carry out its responsibilities."); *Alexander v. "Americans United" Inc.*, 416 U.S. at 774-775 ("[W]here the philanthropic organization is concerned, there appears to be little to circumscribe the almost unfettered power of the Commissioner. This may be very well so long as one subscribes to the particular brand of social policy the Commissioner happens to be advocating at the time . . . but application of our tax laws should not operate in so fickle a fashion.") (Blackmun, J., dissenting).

[5] H.R. Rep. No. 658, 94th Cong., 1st Sess. 284 (1975), reprinted in 1976-3 C.B. (Vol. 2) 976; S. Rep. No. 938, 94th Cong., 2d Sess. 587 (1976), *reprinted in* 1976-3 C.B. (Vol. 3) 625.

In the seventeen years since its enactment, this Court has not had occasion to review the scheme Congress adopted for declaratory judgment review of IRS exemption determinations. The case for review here is compelling because not only do the decisions of the lower courts misapply the substantive provisions for tax exemption under section 501(c)(3), they severely undermine the purposes Congress sought to accomplish in enacting section 7428. By basing their decisions on a ground that the IRS had never raised during CST's administrative proceeding, the lower courts also denied CST due process of law.[6] That the lower courts did so in a case involving a church of an unconventional religious denomination further calls for the writ to be granted, because CST has "suffered interference" and has been disfavored in relation to other churches. *Walz*, 397 U.S. at 676-77. For these reasons, CST respectfully submits that the Court should grant this petition.

I. THE TRIAL COURT MISAPPLIED 26 U.S.C. § 501(C)(3) BY HOLDING CST TO BE NONEXEMPT ON A GROUND WHICH, ALTHOUGH CLASSIFIED AS OPERATIONAL, WAS IN FACT ORGANIZATIONAL. SINCE CST HAD NOT RECEIVED NOTICE THAT ITS ORGANIZATIONAL QUALIFICATIONS WERE AT ISSUE, ITS RIGHT TO DUE PROCESS WAS VIOLATED.

To be exempt from taxation under section 501(c)(3), an organization must be "organized and operated" exclusively for one or more specified exempt purposes. Thus, an organization must pass two separate tests, one as to its organization and

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[6] To receive due process of law, a party must have reasonable notice of the issues to be litigated or it will not have an adequate opportunity to prepare its case. *See, e.g., Mathews v. Eldridge*, 424 U.S. 319, 333 (1976) ("The fundamental requirement of due process is the opportunity to be heard 'at a meaningful time and in a meaningful manner.'") (citations omitted).

another as to its operations. The trial court misapplied these tests.

An organization meets the "organizational" test if its articles of incorporation (or other organizing documents) limit its purpose to one or more of the exempt purposes listed in section 501(c)(3) and if they "[d]o not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities which in themselves are not in furtherance of one or more exempt purposes." Treas. Reg. § 1.501(c)(3)-1(b)(1)(i). Thus, if the organization is empowered to engage in a substantial non-exempt purpose, it fails the organizational test.

In addition, however, the organizational test includes the question of whether an organization was created to carry out a purpose not set forth in its organizational documents:

> [I]n applying the organizational test, a court is not necessarily bound by the recitals in the certificate of incorporation, and in an appropriate case may look beyond the four corners of the creating instrument and consider extrinsic evidence.
>
> > To grant or deny tax benefits to organizations upon a basis of recitations in a charter or certificate would not seem to accomplish what Congress was getting at. The issue of "organized," . . . is primarily a question of fact not to be determined merely by an examination of the certificate of incorporation *but by the actual objects motivating the organization* and the subsequent conduct of the organization.[7]

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[7] *Taxation With Representation v. United States*, 585 F.2d 1219, 1222 (4th Cir. 1978), *cert. denied*, 441 U.S. 905 (1979) (emphasis added) (quoting *Samuel Friedland Foundation v. United States*, 144 F. Supp. 74, 85 (D.N.J. 1956); *accord*, *Colorado State Chiropractic Society v. Commissioner*, 93 T.C. 487, 494-96 (1989); *Peoples Translation Service/Newsfront International v. Commissioner*, 72 T.C. 42, 47-48 (1979).

In contrast, the "operational" test requires that an organization engage "primarily" in activities that accomplish its exempt purpose and that not more than an "insubstantial part of its activities further a nonexempt purpose." Treas. Reg. § 1.501(c)(3)-1(c)(1). The operational test thus seeks to determine whether the organization's actual activities carry out the exempt purposes identified by the organizational test, or whether those activities carry out some other unstated, perhaps non-exempt, purpose. If an organization's actual activities and stated purposes conform, and the stated purposes are exemption related, then the operational test is met.[8]

Under this statutory scheme, it is clear that if an organization is alleged to have an unstated nonexempt purpose but conducts *no* activities in furtherance of such purpose, then the organization cannot be denied exemption on the grounds it has *operated* for such a purpose. Congress has made it equally clear that a favorable declaratory judgment "does not foreclose Service action for later years . . . if . . . the organization's operations have changed since the years to which the declaratory judgment applies, or (especially in the case of a new organization) if the organization *does not in operation* meet the requirements for qualification."[9] Thus, every court that has addressed the issue but those in the case below have consistently followed this express Congressional intent and have refused to speculate in declaratory judgment proceedings that an organization *might* operate in the future for an unstated nonexempt purpose.[10]

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[8] *Goldsboro Art League, Inc. v. Commissioner*, 75 T.C. 337, 343 (1980), *acq.*, 1986-2 C.B. 1; *Federation Pharmacy Services, Inc. v. Commissioner*, 72 T.C. 687, 691 (1979), *aff'd*, 625 F.2d 804, 807 (8th Cir. 1980); *est of Hawaii v. Commissioner*, 71 T.C. 1067, 1078-82 (1979), *aff'd*, 647 F.2d 170 (9th Cir. 1981).

[9] H.R. Rep. No. 658, 94th Cong., 1st Sess. 286 (1975), *reprinted in* 1976-3 C.B. (Vol. 2) 978; S. Rep. No. 938, 94th Cong., 2d Sess. 588 (1976), *reprinted in* 1976-3 C.B. (Vol. 3) 626 (emphasis added).

[10] *Church of the Visible Intelligence That Governs the Universe v. United States*, 4 Cl. Ct. 55, 63 (1983) ("Plaintiff is expressly restricted from

The trial court held that CST failed the operational test on the ground that its primary purpose is not to preserve and protect the Scientology Scriptures but to serve the financial goals of other Scientology entities:

> [CST] has not demonstrated that it is *operated* exclusively for tax-exempt purposes. The administrative record persuades the court that CST was founded for the primary purpose of gaining tax-exempt status to serve the financial goals of other, non-exempt entities, and that CST's archiving activities are secondary to its obtaining tax exemption and would not of themselves qualify CST as a tax-exempt organization under I.R.C. § 501(c)(3).

(B-3) (emphasis added).

The trial court's conclusion that CST is not operated exclusively for exempt purposes was based on CST's options to acquire RTC's rights to the Advanced Technology and Scientology religious marks. The court speculated that the options would be the means by which CST would "serve the financial goals of other, non-exempt entities":

> [T]he court is struck by the centripetal force that will be generated *should* CST obtain tax-exempt status, and *should* it choose to exercise its options to take over assets from RTC. Armed with the trademarks and publishing rights, and with tax-exempt status, CST will be poised in the center of all of Scientology's financial resources, in position to exert a strong

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using its earnings to benefit its officers . . . . [T]he court will not speculate now whether future pay limits will be reasonable."); *see also National Foundation, Inc. v. United States*, 13 Cl. Ct. 486 (1987) (rejecting the possibility of unspecified non-exempt activities); *Junaluska Assembly Housing, Inc. v. Commissioner*, 86 T.C. 1114, 1123, 1125 (1986) ("We are satisfied . . . that petitioner has not *in the period before this Court* . . . engaged in activities to further a substantial non-exempt purpose.") (emphasis added).

> gravitational force on Scientology's income-producing assets. . . .
>
> . . . The *potential* for abuse of the options and copyrights therefore is considerable.

(B-46,47) (emphasis added).

However, because CST has never exercised or utilized the options, or otherwise engaged in *any* activity with respect to the options, the options have not in any way constituted any part of CST's actual activities. Rather, as the trial court specifically acknowledged, since no nonexempt activity could result from the options until they were exercised, they represented at most a "potential" act rather than an actual act.

Thus, any issue presented by the options would lie under the *organizational* test rather than the operational test. But CST was never given notice during the administrative proceeding before the IRS of any issue as to its organizational qualifications, nor of the "factual" grounds ultimately identified by the trial court. Because CST was provided no opportunity to build a record on an issue under the organizational test, the trial court not only misapplied section 501(c)(3) when it based its holding on an organizational issue but it also denied CST due process.[11]

Because the IRS never gave CST notice that its organizational qualifications were at issue, the *only* legitimate question before the trial court was whether CST's actual activities manifested a substantial non-exempt purpose. The lower court specifically found that most, if not all, of CST's actual activities furthered its exempt religious purposes (B-40). A colloquy between government counsel and the appeals court also makes clear that the government's argument and the courts' decisions were not based on any actual activity conducted by CST that

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[11] The trial court itself, apparently not understanding the difference between the organizational and operational tests, actually held that CST had met the organizational test (B-35), which the government itself had conceded.

furthered a nonexempt purpose.[12] None of the opinions below, nor any of the government's briefs or other pleadings, nor CST's record before the IRS identifies any act by CST that furthers any purpose other than the religious purposes stated in its organizational documents.

II. THE TRIAL COURT MISAPPLIED 26 U.S.C. § 7428 BY HOLDING CST TO BE NON-EXEMPT ON A GROUND NOT SET FORTH IN THE INTERNAL REVENUE SERVICE'S FINAL ADVERSE RULING, THEREBY VIOLATING CST'S RIGHT TO DUE PROCESS.

A. The Trial Court Was Limited to the Internal Revenue Service's Final Adverse Ruling as the Basis For Its Decision.

In enacting section 7428, Congress specifically provided that a reviewing court must base its decision "upon the reasons provided by the Internal Revenue Service in its notice . . . or

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[12] THE COURT: You agree the archiving is okay?

MR. RAPP: There is certainly nothing wrong with the archiving. Remember (interruption) . . .

THE COURT: You have to go beyond archiving and find that they are doing something else now?

MR. RAPP: No, I don't think that we have to find that they are doing anything else now (interruption) . . .

THE COURT: Then what is it we have to find?

MR. RAPP: We have to find what the purpose of the organization is in its operation, and Judge Bruggink found (interruption) . . .

THE COURT: You have to find out that their "now purpose" goes beyond what they are currently now doing.

MR. RAPP: Precisely, Your Honor . . . .

(F-88).

based upon any new argument which the Service may wish to introduce at the time of trial."[13]

The rules governing the allocation of the burden of proof that Congress intended be followed in actions under section 7428[14] and that the Court of Federal Claims has chosen to follow[15] impose the burden of proof on the organization "as to the grounds set forth in the notice of determination."[16] The government, on the other hand, bears the burden of proof "as to any ground . . . which is not stated in the notice of determination."[17] Thus, it generally is appropriate to allow the government to raise new grounds at the time of trial because the government will bear the risk of nonpersuasion if the record does not support its new allegations.[18] This allocation of the burden of proof serves the fundamental due process function of ensuring that an organization has notice of and adequate opportunity to respond to substantive grounds asserted by the IRS.[19]

The test for a new ground is whether the applicant was adequately apprised of the underlying factual basis so that it had the opportunity to present evidence and argument during the administrative proceeding.[20] Thus, whether an IRS position

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[13] H.R. Rep. No. 658 at 285, 1976-3 C.B. (Vol. 2) at 977; S. Rep. No. 938 at 588, 1976-3 C.B. (Vol. 3) at 626.

[14] H.R. Rep. No. 658 at 285-86, 1976-3 C.B. (Vol. 2) at 977-78 ("The burden-of-proof rules . . . should conform to the rules that the Tax Court develops with regard to declaratory judgment suits as to retirement plans."); S. Rep. No. 938 at 588, 1976-3 C.B. (Vol. 3) at 626 (same).

[15] *See, e.g., Church of the Visible Intelligence*, 4 Cl. Ct. at 60.

[16] Tax Court Rule 217(c)(2)(A).

[17] Tax Court Rule 217(c)(2)(B).

[18] *Dumaine Farms v. Commissioner*, 73 T.C. 650, 660 (1980).

[19] *Peoples Translation Serv./Newsfront Int'l v. Commissioner*, 72 T.C. 42, 51 (1979).

[20] *See Virginia Educ. Fund v. Commissioner*, 85 T.C. 743, 751 (1985) ("[P]etitioner was well aware from the outset [of] respondent's sole and

was raised in the final adverse ruling, so that the organization bears the burden of proof, necessarily turns on the factual grounds the IRS identified in its determination:

> The role of the IRS is not simply to develop evidence and then make bald faced conclusions. By doing so, the IRS would leave it to the Court to ascertain what evidence in the record could support those conclusions. In effect, this makes the Court the finder of fact in the first instance. That is not the Court's function in this case. There is a difference between performing a *de novo* review and being the initial finder of fact.[21]

The trial court was obligated to adhere to the parameters Congress established for section 7428.[22] The court exceeded these parameters by basing its decision on a new ground which the IRS had never raised with CST and as to which the court did not require the IRS to bear the burden of proof. The appeals court not only perpetuated the lower court's error, it in fact compounded it: By expressly holding that CST failed to establish that it was organized for exempt purposes, it made clear it recognized that its endorsement of the unstated, nonexempt purpose found by the lower went to the organizational test, not the operational test. In so doing, it expressly found CST to have

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unambiguous ground for revocation"), *aff'd*, 799 F.2d 903 (4th Cir. 1986); *Dumaine Farms*, 73 T.C. at 659-60 (organization on notice because new ground was expressly raised in IRS answer; factual basis for new ground reflected in documentation required with exemption application); *Peoples Translation Serv.*, 72 T.C. at 51 ("Petitioner has had no opportunity to answer [the new ground] with factual data.").

[21] *Airlie Found., Inc. v. United States*, 92-2 U.S. Tax Cas. (CCH) ¶ 50,462 (D.D.C. 1992) (remanding case for an explanation by the IRS as to the factual grounds in the administrative record for its conclusions).

[22] *See, e.g., Bender v. Williamsport Area School Dist.*, 475 U.S. 534, 541 (1986); *Switchmen's Union of N. America v. National Mediation Bd.*, 320 U.S. 297, 301, 304-06 (1943).

failed to carry its burden of proof on a new issue not even properly before the court.

B. The Trial Court Based its Decision on Reasons Not Set Forth in the Internal Revenue Service's Final Adverse Ruling, Thereby Violating CST's Right to Due Process.

As noted in Section I above, the trial court's basic holding was that:

> CST was founded for the primary purpose of gaining tax-exempt status to serve the financial goals of other, non-exempt entities, and that CST's archiving activities are secondary to its obtaining tax exemption and would not of themselves qualify CST as a tax-exempt organization under I.R.C. § 501(c)(3).

(B-3).

Although these reasons were never raised by the IRS at the administrative level or by the government in its answer or even in its brief on the merits, the court did not require the IRS to bear the burden of proof as to this new ground.

CST's complaint in the trial court set forth in detail how the IRS's stated reason for denying exemption for inurement and a "substantial nonexempt purpose" was not supported by the facts in the record. In its answer, the government simply denied CST's allegations but did not allege any additional reason to support the IRS's conclusion.

Before the trial court, CST also established that the IRS's stated reason for denying exemption was invalid. The government never responded to CST's proof, nor did it ever reassert the reason the IRS gave for denying CST's exemption. Instead, in its brief on the merits, the government asserted a new reason for denying exemption — that CST's purpose is to preserve the "inherently commercial" orthodox practice of Scientology. The government took this position even though it contradicted the

IRS's express determination that the organizational purpose stated in CST's articles of incorporation— to "ensure and maintain the purity and integrity of the religion of Scientology" — was an exempt religious purpose under section 501(c)(3).

At oral argument on the merits before the trial court, the government abandoned its prior arguments — conceding that there was nothing in the record showing inurement or that CST engaged in any commercial activity — and, as discussed above, constructed a new ground for denying exemption. It was on this new ground that the trial court determined that CST "was founded for the primary purpose of gaining tax-exempt status to serve the financial goals of other, non-exempt entities" (B-3).

The trial court did not base its holding on any ground stated in the IRS's final adverse ruling or any "new argument which the Service may wish to introduce at the time of the trial," which should have been stated in the government's answer.[23] Had the government properly raised this new ground at trial, it would have had to bear the burden of proof to show this was CST's actual purpose.[24] However, the government did not raise this new ground in its answer, or even in its brief on the merits; the ground therefore should not have been considered by the court at all, let alone have formed the basis for its decision.

Nor could the trial court ignore Congress' directive to limit its determination to the reasons given by the IRS on the justification that its ultimate conclusions "were based on the same evidence and underlying concerns as those of the Commis-

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[23] Tax Court Rule 213(a)(2) ("[T]he answer shall contain a clear and concise statement of every ground, together with the facts in support thereof, on which the Commissioner relies and has the burden of proof."); *Dumaine Farms*, 73 T.C. at 659-60; *see Church of Spiritual Technology v. United States*, 18 Cl. Ct. 247, 250 (1989) ("Congress expected . . . this court to follow the practices of the Tax Court.").

[24] Tax Court Rule 217(c)(2)(B).

sioner" (C-65). The trial court's reason for denying exemption differed from *every* reason ever advanced by the IRS or, up until oral argument, by the government. "Evidence" and "concerns" do not equal reasoning, and it is only the reasoning on which the IRS's conclusion is based that CST is required to challenge:

> The task of a reviewing court is made materially more difficult when it is denied the insights arising from adversarial comment on an agency rationale. Moreover, it is always uncertain when confronted with an *ex post* rationale, whether the agency would have in fact initially reached the result which it is called upon to justify retroactively. For these reasons, reviewing courts ordinarily decline to find agency decisions adequately supported by theories newly presented upon review.[25]

The trial court's acceptance of the government's *ex post* rationale denied CST any opportunity to demonstrate that the IRS's position had no merit. Because this action is not permitted by section 7428, the trial court denied CST due process.

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[25] *Blanco Oil Co. v. FERC*, 598 F.2d 152, 166, n.70 (D.C. Cir. 1979) (citation omitted).

CONCLUSION

The Court should be aware of the severe consequences to CST from the lower courts' decisions. Although the government attorney suggested in oral argument before the appeals court that CST could simply reapply to the IRS and make a fuller record, the IRS takes a much different position, namely, that exemption for CST in a new administrative proceeding would be effective *only* from the date of the new application. Under the IRS's position, even if CST were to reapply tomorrow, CST would have to litigate its exempt status for earlier years in deficiency or refund proceedings and would be required to establish as a threshold matter its entitlement to institute such a proceeding. Unless CST establishes its exempt status, it will not be eligible to receive Mr. Hubbard's generous, essential bequest. And if CST does not receive the bequest Mr. Hubbard intended for it, his careful plan to preserve his religious teachings for humanity for all time will be severely compromised.

The consequences to the structure and integrity of the administration of the laws of tax exemption are no less grave. By allowing the lower courts' decision to stand, this Court will permit the IRS to do to other exemption applicants what it did to CST: to keep it in administrative proceedings for nearly five years, only to abandon every factual and legal basis raised during that period and to concoct an *ex post* rationale at the last minute to which the organization can have no opportunity to respond. In short, allowing the lower courts' decisions to stand will thoroughly undermine Congress' purpose in enacting section 7428 by giving back to the IRS its "unfettered power" over exemption determinations[26] just as "susceptible of abuse"[27] as it was before 1976. Finally, allowing the lower courts' decisions to stand will send a clear message to the IRS that in the case of

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[26] *Alexander v. "Americans United" Inc.*, 416 U.S. 752, 744 (1974) (Blackmun, J., dissenting).

[27] *Bob Jones University v. Simon*, 416 U.S. 725, 750 (1974).

new organizations espousing nonmajoritarian doctrines it can pursue whatever "brand of social policy the Commissioner happens to be advocating at the time"[28] without risk of meaningful judicial scrutiny.

For the reasons stated, the petition for writ of certiorari should be granted.

Respectfully submitted,

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[28] *Alexander*, 416 U.S. at 775 (Blackmun, J., dissenting).